

DEPARTMENT OF STATE REVENUE

Revenue Ruling #2020-04ST
October 29, 2020

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ISSUES

Sales and Use Tax - Acetone Used for Cleaning Equipment Used and Consumed in Manufacturing

Authority: [IC 6-2.5-2-1](#); [IC 6-2.5-3-2](#); [IC 6-2.5-5-5.1](#); [45 IAC 2.2-5-12](#); *Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96 (Ind. Ct. App. 1974); *Indiana Dept. of State Revenue v. Kimball Int'l Inc.*, 520 N.E.2d 454 (Ind. Ct. App. 1988); *Guardian Automotive Trim, Inc. v. Indiana Department of State Revenue*, 811 N.E.2d 979 (Ind. T.C. 2004).

A taxpayer ("Company") seeks a ruling regarding whether the purchase of acetone qualifies for an exemption from Indiana sales and use tax in each of the following operations:

- To clean and flush spray guns and spray gun lines after every fifth mold.
- To manually clean spray gun tips and parts.
- To clean gel coating equipment after each color change.
- To clean the auto rollers after 20 minutes of use.

STATEMENT OF FACTS

Company is a manufacturer of fiberglass reinforced plastic (FRP) panels for the Recreational Vehicle (RV) industry with an operating plant in Indiana. Company provides the following information regarding the transactions at issue, reproduced exactly as submitted in Company's request for a ruling, but with certain details redacted or added from further correspondence:

[Company] manufactures large flat fiber panels composed of thermoset polyester resin, chopped fiberglass strands, wood paneling, and abrasion resistant gel coat. The panels are produced based on job orders. [Company] maintains molds that are used to produce the panels. The molds are sprayed with two coats of the gel coat which gives the panels both color and shine. Pumps and scales are used on the gel coat lines to ensure that the proper mix of gel coat is applied. The molds then proceed through a curing tunnel to cure the gel coat. The temperature in the plant must be maintained at 85 degrees during production operations to produce marketable panels. After the gel coat is cured in the curing tunnels, the panels then proceed to lamination. Large overhead cranes and hoists are used to transport the panels to lamination. In lamination, 2 layers of resin are sprayed on the panels. Additionally, strands of fiberglass are chopped and sprayed on the panels. The fiberglass comes in on reels and is fed into a chopper for spraying. Plywood, which was cut in the wood department, is then applied to the panel. This forms the back of the exterior wall panel. More fiberglass is sprayed on the wood panel backing and then mylar material is also applied. After the lamination process, a large hoist clamps all sides of the panel, lifts it and vacuum pumps are used to suck out any air from the resin. After the panels are removed from the molds, they then proceed to [computer numerical control, or CNC] cutting operations and finishing operations such as sanding. Depending on job orders, some panels are cut to specific sizes and shapes using CNC routers. In the final finish department, all panels are inspected for quality assurance and any defects are repaired. Because of the size of the panels, [Company] uses shipping tables to sequence the panels prior to final packaging. These sequencing operations are an essential and integral step of the manufacturing process so that the panels can be properly packaged and labeled for shipment to customers.

Because the manufacturing process creates toxic gases, dust and other contaminants that are harmful to the outdoor environment, [Company] operates [a regenerative thermal oxidizer, or "RTO"] system designed to capture these contaminants produced from its production process. This system is required to comply with Federal, state, and local standards for air pollution. The natural gas-fired burners in the RTO system burns off all the harmful gases and contaminants to the point that the only thing expelled is CO2 and moisture. Additionally, [Company] operates dust collectors to collect dust from sawing operations so that this dust is not released into the atmosphere.

...

[Company] uses and consumes acetone at various stages in its production of FRP panels. Acetone is used in the following operations:

- Acetone is used continuously in the lamination and gel coating processes as part of the direct and integrated production process. Acetone is used to flush the spray guns every 5th mold during the production process to prevent the gun tips and lines from clogging. This allows for a continuous and uninterrupted production process and an even and uniform spray on the parts. This process accounts for about 20% of the total acetone usage.
- Acetone is used and consumed in the lamination and gel coat processes to manually clean the spray guns tips and the pump parts. Manual cleaning of the spray tips includes continuously dipping the spray guns into buckets of acetone. This prevents the gun tips and [lines] from clogging during the production process. The acetone in the buckets is . . . periodically replaced. This process accounts for about 10% of the total acetone usage.
- Acetone is used and consumed in the gel coating process for color flushing. The color flushing occurs anytime there is a change in color and occurs during the direct and integrated production process. This process accounts for about 10% of the total acetone usage.
- Acetone is used to clean the auto-rollers [meaning machines designed to press chopped glass fibers into the resin to insure good adhesion to the layer below before the next layer is applied]. The rollers are removed every 4th mold (approximately every 20 minutes) and clean rolls are immediately installed for a continuous production process. The dirty rollers are then cleaned with acetone and made ready to be put back into production 20 minutes later. This must be completed while production is running. This process accounts for about 50% of the total acetone usage.
- A small percentage of acetone is also used in the Mold Department to clean the molds just prior to resurfacing, which is general maintenance. This usage accounts for less than 2% of the total acetone usage.

DISCUSSION

Company requests the Department to issue a Ruling regarding the application of Indiana sales and use tax to purchases of acetone used and consumed in its production process.

Indiana imposes an excise tax called "the state gross retail tax" (or "sales tax") on retail transactions made in Indiana. [IC 6-2.5-2-1\(a\)](#). A person who acquires property in a retail transaction (a "retail purchaser") is liable for the sales tax on the transaction. [IC 6-2.5-2-1\(b\)](#). Indiana also imposes a complementary excise tax called "the use tax" on "the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction." [IC 6-2.5-3-2\(a\)](#).

In general, all purchases of tangible personal property are subject to sales and/or use tax unless an enumerated exemption from sales and/or use tax is available. Property is exempt from use tax if such property is also exempt from sales tax under [IC 6-2.5-3-4\(a\)\(2\)](#), if ". . . the property was acquired in a transaction that is wholly or partially exempt from the state gross retail tax under any part of [IC 6-2.5-5](#), except [IC 6-2.5-5-24\(b\)](#), and the property is being used, stored, or consumed for the purpose for which it was exempted."

Indiana law provides the standard by which tax exemptions are to be interpreted. In applying any tax exemption, the general rule is that "tax exemptions are strictly construed in favor of taxation and against the exemption." *Indiana Dept. of State Revenue v. Kimball Int'l Inc.*, 520 N.E.2d 454, 456 (Ind. Ct. App. 1988). A statute which provides a tax exemption, however, is strictly construed against the taxpayer. *Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96, 97 (Ind. Ct. App. 1974). "[W]here such an exemption is claimed, the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." *Id.* at 100-101.

Company believes that the use of the acetone qualifies for the direct consumption manufacturing exemption provided in [IC 6-2.5-5-5.1\(b\)](#). This statute provides as follows in relevant part:

Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for direct consumption as a material to be consumed in the direct production of other tangible personal property in the person's business of manufacturing, processing, refining, repairing, mining, agriculture, horticulture, floriculture, or arboriculture.

Company explains the necessity of the acetone, claiming that the cleaning of the spray guns, spray gun tips, pump parts, pump lines and auto-rollers does not stop the production process because Company cleans these parts as part of its direct and integrated production process.

[45 IAC 2.2-5-12](#) goes on to provide in pertinent part:

- (a) The state gross retail tax shall not apply to sales of any tangible personal property consumed in direct production by the purchaser in the business of producing tangible personal property by manufacturing, processing, refining, or mining.
- (b) The exemption provided by this regulation [\[45 IAC 2.2\]](#) applies only to tangible personal property to be directly consumed in direct production by manufacturing, processing, refining, or mining. It does not apply to machinery, tools, and equipment used in direct production or to materials incorporated into the tangible personal property produced.
- (c) **The state gross retail tax does not apply to purchases of materials to be directly consumed in the production process or in mining, provided that such materials are directly used in the production process; i.e., they have an immediate effect on the article being produced. The property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property.**
- (d) Pre-production and post-production activities.
 - (1) Direct consumption in the production process begins at the point of the first operation or activity constituting part of the integrated production process and ends at the point that the production process has altered the item to its completed form, including packaging, if required.
- ...
- (e) "Have an immediate effect upon the article being produced or mined." Purchases of materials to be consumed during the production or mining process are exempt from tax, if the consumption of such materials has an immediate effect upon the article being produced and mined, or upon machinery, tools, or equipment which are both used in the direct production or mining process and are exempt from tax under these regulations [\[45 IAC 2.2\]](#).
- (f) Other taxable transactions. Purchases of materials consumed in manufacturing, processing, refining, or mining activities beyond the scope of those described in subsection B above *[subsection (e) of this section]* are taxable. Such activities include postproduction activities; storage step) *[sic.]*; **maintenance, testing and inspection (except where in direct production); (except where essential and integral to the process system)**; management and administration; sales; research and development; exhibition of products; safety or fire prevention; space heating; ventilation and cooling equipment for general temperature control; illumination; shipping and loading.
- (g) "Consumed" as used in this regulation [\[45 IAC 2.2\]](#) means the dissipation or expenditure by combustion, use, or application and does not mean or include the obsolescence, discarding, disuse, depreciation, damage, wear or breakage of tools, dies, equipment, machinery, or furnishings. **(Emphasis added).**

Company cites to an Indiana Tax Court decision, *Guardian Automotive Trim, Inc. v. Indiana Department of State Revenue*, 811 N.E.2d 979 (Ind. T.C. 2004), in which the court found that Guardian's use of acetone qualified for exemption as directly consumed in the direct production of tangible personal property pursuant to [IC 6-2.5-5-5.1\(b\)](#). Guardian sprayed liquid plastic into molds that were used in the production process. After the molded plastic dried, the parts were sprayed with "resist." This coating prevented electroplating metals and chemicals from adhering to the molds in the wrong places and rendering the product unmarketable. The masks were cleaned with acetone after every 15 to 50 uses. In reaching its conclusion, the court found that Guardian could not produce a marketable product without the cleaning process and that the production process was only stopped momentarily for the cleaning of the masks. The court determined that the cleaning of the masks was an integral and essential part of the production process. Therefore, the court found that the acetone was directly consumed in the direct production process.

If acetone was not used to clean the production machinery and equipment and related parts, Company argues that it would not be able to produce a marketable product. Additionally, the acetone must be frequently changed during production operations, so it is used and consumed in the direct production process of FRP panels in the ways described above. This shows that it is necessary to the production process. However, it is important to note that the court in *Guardian* focused on the fact that the acetone and the mask processing equipment had an immediate effect on Guardian's manufactured automotive components, not that it was necessary to the production process. In other words, it is not enough that the acetone is necessary in the production process. It must also have an immediate effect on the article being produced, meaning the acetone is "an essential and integral part of an integrated process which produces tangible personal property." [45 IAC 2.2-5-12\(c\)](#).

Company also refers to Letters of Findings that affirmed the exempt use of acetone in the processes of the taxpayers at issue: Letter of Findings No. 04-20050321 (February 28, 2007, [20070228-IR-045070103NRA](#)); and Letter of Findings No. 04-20120337 (November 18, 2012, [20121128-IR-045120603NRA](#)). In the latter Letter of Findings, the Department determined that the use of acetone to clean exempt production equipment during the production process was not a nonexempt routine cleaning and maintenance use under [45 IAC 2.2-5-12\(f\)](#), but rather it was used in an "integral part of an integrated process which produces tangible personal property" under [45 IAC 2.2-5-10\(g\)](#). Therefore, the use was exempt under [IC 6-2.5-5-1](#).

Based on the relevant statutes and regulations, as well as guidance from the Tax Court in the *Guardian* case and the above-mentioned Letters of Findings, the Department concurs with Company that the consumption of the acetone in the following instances are exempt:

- To clean and flush spray guns and spray gun lines after every fifth mold.
- To manually clean spray gun tips and parts during the production process to prevents the gun tips from clogging.
- To clean gel coating equipment after each color change.
- To clean the auto rollers after 20 minutes of use.

All four of the above uses of acetone has an immediate effect on the article being produced. It is consumed in such a way that it is an essential and integral part of an integrated process which produces tangible personal property. All of the equipment listed above are themselves directly used in direct production under [IC 6-2.5-5-3](#), and this equipment would not function properly without the consumption of the acetone during production. Therefore, the consumption of the acetone is exempt under [IC 6-2.5-5-1](#).

RULING

Company's purchase of acetone is exempt to the extent that it is used to: clean and flush spray guns and spray gun lines after every fifth mold; manually clean spray gun tips and parts; clean gel coating equipment after each color change; and clean the auto rollers after 20 minutes of use. When used in those circumstances, the acetone is directly consumed in the direct production of tangible personal property pursuant to [IC 6-2.5-5-1](#). The acetone is not exempt when it is used for other purposes, even with regard to the equipment described above when it is not being used in production or when production is shut down.

CAVEAT

This ruling is issued to the taxpayer requesting it on the assumption that the taxpayer's facts and circumstances as stated herein are correct. If the facts and circumstances given are not correct, or if they change, then the taxpayer requesting this ruling may not rely on it. However, other taxpayers with substantially identical factual situations may rely on this ruling for informational purposes in preparing returns and making tax decisions. If a taxpayer relies on this ruling and the Department discovers, upon examination, that the fact situation of the taxpayer is different in any material respect from the facts and circumstances given in this ruling, then the ruling will not afford the taxpayer any protection. It should be noted that subsequent to the publication of this ruling a change in statute, regulation, or case law could void the ruling. If this occurs, the ruling will not afford the taxpayer any protection.

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